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No. 91-194

In The

Supreme Court of the United States

October Term, 1991

Quill Corporation,

Petitioner,

v.

State of North Dakota,
by and through its Tax Commissioner,
Heidi Heitkamp,

Respondent.

On Writ of Certiorari to the Supreme Court of the State of North Dakota

BRIEF OF THE AMICI CURIAE AMERICAN BANKERS ASSOCIATION AND AMERICAN FINANCIAL SERVICES ASSOCIATION IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether the North Dakota Supreme Court is obligated to follow the longstanding precedent of *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), in a case that is factually indistinguishable from *Bellas Hess*?

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INTEREST OF THE AMICI CURIAE

The American Bankers Association and the American Financial Services Association (hereinafter the "Associations") hereby respectfully submit this brief as amici curiae in support of the Petitioner and with the consent of both of the parties. The signed consents of each are filed together with this brief.

The American Bankers Association ("ABA") is the principal national trade association of the commercial banking industry in the United States, having as members both national and state-chartered banks, located in each of the fifty states and the District of Columbia. Member banks of the Association range from the smallest of community banks through regional, super regional and money center banks. Collectively, our membership holds over ninety percent of the assets of all domestic commercial banks.

The American Financial Services Association ("AFSA") is the principal national trade association representing non-bank providers of consumer financial services across the United States. These companies range from independently-owned consumer finance companies to the nation's largest financial services, retail and automobile companies. AFSA's members hold over $190 billion of consumer credit outstanding and over $50 billion in second mortgage credit—representing approximately one quarter of all consumer credit outstanding in the United States.

The Associations respectfully submit this brief to urge the Court to reverse the decision of the Supreme Court of North Dakota below. The court, in that decision, concluded that this Court's decision in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), is not controlling precedent even though directly on point.

This case deals with the right of a state to require an out-of-state seller to collect sales and use tax and directly presents the question whether this Court's decision in *Bellas Hess* continues to be valid precedent.

Banks and other financial institutions, like any other for-profit business, are subject to state taxes. In a modern economy, financial institutions may have a substantial number of customers located in states where the financial institution itself does not and is not authorized to do business. Consequently, questions about which states may tax a financial institution, how such tax would be imposed, and the amount of such tax are of great importance to the commercial banking and financial service industries.

The Associations believe that *Bellas Hess* is still good law and should be reaffirmed. We adopt and support the arguments that the Petitioner advanced in the court below and will claim in this Court. Moreover, in addition, the Associations wish to bring to the Court's attention a somewhat different perspective which should not be overlooked as the Court considers this case.

SUMMARY OF THE ARGUMENT

The physical presence test for taxation is of enormous interest to the commercial banking and financial services industries. Financial transactions (*e.g.*, taking deposits and making loans) are conducted across state lines not only to facilitate commerce, but more importantly because state law restrictions bar the physical presence of financial institutions chartered in other states. Any move to abandon a physical presence test for state taxation in favor of an "economic presence" test would be an extraordinary expansion of state taxing authority, with consequences well beyond the mail-order sales and use tax issue presented in the *Quill* case. The Associations urge the Court not to prejudge the validity of the "economic pres-

ence" approach as it applies to state income or franchise taxes on financial institutions. That issue will come another day.

* *Bellas Hess* has not been eroded by some evolution of the doctrine of "nexus" as the court below has ruled. This Court has reaffirmed its holding in *Bellas Hess* on several occasions, most recently in 1989. However, our brief argues that, if this Court reconsiders its position on physical presence as a basis for sales and use tax collection, it should retain the physical presence standard for applying the Commerce Clause and Due Process Clause in determining state income or franchise tax jurisdiction.

ARGUMENT

If This Court Affirms The Jurisdiction Of A State Or Local Tax Authority To Require An Out-Of-State Mail Order Vendor To Collect And Remit Applicable Sales And Use Taxes On Sales To In-State Residents, The Holding Should Be Limited To The Collection And Remittance Of Sales And Use Taxes.

The ultimate issue presented by this case is whether *Bellas Hess* remains good law in light of this Court's evolving nexus doctrine. The Respondent's determination that this Court's decision in *Bellas Hess* is "obsole[te]", and therefore not binding on the courts of North Dakota is misplaced. Contrary to the North Dakota court's analysis, no legal or factual change has undermined the principles of *Bellas Hess*.[1] Despite

[1] In this regard, the Associations have what might be called a "corporate interest" as well as a representative interest on behalf of their memberships. Like many national nonprofit trade associations, the ABA and AFSA distribute educational products

the North Dakota court's protestations, this Court has never doubted *Bellas Hess*, and its rulings have consistently followed *Bellas Hess* since 1967.

The Associations believe that *Bellas Hess* is still good law and should be reaffirmed for the reasons set forth in the Brief of the Petitioner. No point would be served by our repetition of those arguments which we support. However, if this Court determines that technological advances and economic developments have so dramatically changed the mail order industry since the 1967 *Bellas Hess* decision as to render its holding obsolete, then any new nexus standard adopted by this Court should be limited to use tax collection responsibility only; and not expanded to the imposition of other kinds of taxes, such as an income or franchise tax, that may be applicable to banks and other entities that do not enjoy the immunity from income based taxes provided by P.L. 86-272, 15 U.S.C. 381 (1959).[2]

to their members in all fifty states by mail or common carrier; but do not have a physical presence in most of those states. If this Court overrules *Bellas Hess*, the Associations will become liable for the administrative and recordkeeping burden of dealing with a multitude of different tax structures which this Court correctly found to exist in 1967 and which continue to exist today. Imposing these burdens now would frustrate, impede, and defeat the tax-exempt purposes of these and similarly situated associations by diverting limited resources away from educational and information services to unproductive uses.

[2] P.L. 86-272, among other protections, prohibits states from taxing the income earned by out-of-state retailers or manufacturers which have no physical presence within the state and whose only contacts with the state are by mail or common carrier. Since only sellers of tangible personal property enjoy the immunity provided by P.L. 86-272, the concern raised in this argument equally applies to all service providers, not only banks.

1. The Bright Line Physical Presence Test Is Essential In Determining Income Or Franchise Tax Jurisdiction.

With respect to use taxes, the out-of-state retailer, while bearing the substantial and onerous collection and compliance burden, does not itself directly bear the burden of the tax. The direct burden of the tax falls solely on the in-state resident customer. As is appropriate, the taxpayer (*i.e.*, the in-state customer) is the primary beneficiary of the infrastructure of the state of residence.

With an income or franchise tax, on the other hand, a nonresident service provider such as a bank (as opposed to the in-state customer) would be the taxpayer on whom the direct tax falls. An entity with no physical presence in the taxing state, that conducts its interstate business in a manner like that of National Bellas Hess, and, therefore, does not benefit from the infrastructure of the state in which its customers reside, should not bear any direct tax burden sought to be imposed by that state.[3]

[3] Indeed, this Court has long recognized that a higher nexus threshold applies with respect to the taxation of an out-of-state seller than with respect to an in-state resident. The cases of *McLeod v. Dilworth Co.*, 322 U.S. 327 (1944), and *General Trading Co. v. Tax Commissioner*, 322 U.S. 335 (1944), are illustrative in this regard. These cases involved virtually identical facts except that *McLeod* involved a sales tax imposed directly upon an out-of-state retailer and *General Trading Co.* involved a use tax collection responsibility imposed upon an out-of-state retailer. In both cases, the out-of-state corporations were not qualified to do business in the taxing state and had no office or place of business there but did solicit orders from its residents by traveling salesmen. In the *McLeod* case, the sales tax was held unconstitutional; in the *General Trading Co.* case, the use tax collection responsibility was upheld. The dissents, in both cases, make it apparent that the majority reached different results in the two cases solely because of the nature of the tax imposed. The *McLeod* court recognized this to be a difference of substance and not merely form.

Moreover, with respect to taxes imposed on, or measured by, net income, another important distinction is that manufacturers and retailers generally are protected from such tax derived from selling tangible personal property, so long as their activities do not exceed the permissible boundaries of P.L. 86-272. Even this protection established by Congress, because it does not provide a bright line standard of nexus, has resulted in years of litigation.

Banks, finance companies, and other service providers, continue to require a bright line nexus standard since they do not enjoy any of the protections of P.L. 86-272[4]—however such protections may be interpreted by this Court. In addition, a bright line test is imperative for orderly interstate commercial activity in so far as it brings certainty to business planning and the ability to comply with state tax laws. A substantial local presence rule, such as that mandated by

[4] At the time P.L. 86-272 was adopted in 1959, national banks were already federally protected from the threat of state taxation, by a state other than the state in which it was located, under the National Bank Act of 1864 (Section 5219 of the Revised Statutes). Thus, there was no need for Congress to include financial institutions under the umbrella protection of P.L. 86-272. However, the protection under the National Bank Act of 1864 was removed with the passage of the State Taxation of Depositories Act of 1969. The 1969 Act was delayed by various Public Law enactments and finally became law when P.L. 93-100 expired in September 1976. Thus, today, national banks are subject to nondiscriminatory state taxation *provided* the bank has a taxable nexus with the state and the tax is not otherwise unlawful.

Bellas Hess, enhances and protects interstate activity by allowing a business which chooses to conduct its activities from its home state to do so under conditions of certainty without fear of "local entanglements", often unexpected, inadvertent and not easily determinable. Any departure from a bright-line test such as the physical presence standard established by *Bellas Hess* will lead to confusion and continued expensive litigation over the degree of "economic presence" that is required before a state has the requisite jurisdiction to tax.

Accordingly, the commercial banking and financial service industries are wary of any expansion of the scope of income or franchise tax jurisdictional standards, whether by the states or by Congress, irrespective of any changes to the jurisdictional standards applicable in the area of use tax collection responsibility.

2. The Failure To Restrict Any Expanded Jurisdictional Standard To Sales And Use Taxes Will Adversely Affect The Commerce Clause Standard As It Applies To Income Or Franchise Taxes.

If the Court permits any expansion of tax jurisdiction standards to income or franchise taxes, then it may soon be called upon to address the Commerce Clause limitations on state taxation of out-of-state financial institutions as well as other service industries. As enunciated in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), a state tax imposed on an out-of-state corporation will not pass scrutiny under the Commerce Clause unless "the tax is (1) applied to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the state." 430 U.S. at 279.

Consequently, if the nexus standard is expanded, this Court could soon be asked to determine the applicability of the "economic presence" theory to taxation of out-of-state financial institutions. The Court would be presented with such questions as minimum contacts, fair apportionment, discrimination against out-of-state financial institutions, and the relationship of the tax burden to the services provided by the state.

The minimum contacts question has a unique status with respect to banks and overlaps with the issue of discrimination against out-of-state corporations. Banks have long been subject to state law prohibitions against branching[5] as well as prohibitions imposed on bank holding companies against acquiring offices beyond their home state.[6] To date, only eleven states permit non-reciprocal nationwide banking through a bank holding company structure (but not interstate branching), while the remaining thirty-nine limit the bank holding company's ability to enter their markets. Notwithstanding these restrictions, four states (Minnesota, Indiana, Tennessee and West Virginia) have enacted "economic presence" statutes that assert that

[5] Under the McFadden Act, 12 U.S.C. 36, intrastate branching by national banks is permitted to the same extent as similarly situated state-chartered banks can establish branches. Under the Act, however, interstate branching by national banks is prohibited.

[6] Under the Bank Holding Company Act, 12 U.S.C. 1843(d), out-of-state bank holding companies are prohibited from acquiring a bank in another state unless expressly authorized by state law.

banks are subject to income or franchise taxes based on the mere presence of 20 credit card customers or $5 million of assets within their states—even though the out-of-state bank is legally barred from opening a branch. Such discrimination against a nonresident is prohibited under the third prong of the *Complete Auto* standard.

Furthermore, if an "economic presence" standard is adopted by this Court but it is not limited to sales and use taxes, the Court could become entangled in the thorny questions of judicially fashioning rules apportioning bank income among the states. These are especially difficult apportionment issues because the states that have adopted an "economic presence" standard for taxing the income of financial institutions have not adopted uniform apportionment rules. Each state tends to skew the formulae in order to obtain the greatest possible tax revenue, without regard to the absence of real and substantial services derived by the tax-burdened financial institutions. At the same time, the state that truly provides services to the financial institution, *i.e.*, the state of domicile, taxes the same income that is sought by the state in which an "economic presence" is deemed to exist. Since the financial institution's state of domicile does not permit a tax credit for income taxes paid to other states, double, and in some cases perhaps multiple, tax is imposed on the same dollar of earnings.

3. As A Matter Of Public Policy, This Court Should Not Expand The Jurisdiction Of State And Local Governments To Impose Taxes Based On The Income Of Out-Of-State Financial Institutions.

The Associations respectfully urge the Court to note several important public policy considerations that could affect the commercial banking and financial service industries if the general applicability of the *Bellas Hess* standard is eroded.

First, expanded tax jurisdiction will lead to multiple taxation of the same income because the states do not agree on a uniform division of financial institution income. At issue, therefore, is the ability of the banking industry to conduct its business—accept deposits and make loans—in a safe and sound manner as mandated by its regulators. State and local tax expense, and the threat of multiple state tax exposure, are significant financial risks facing the American banking and financial services industries today. In addition, the lack of uniformity among the states adopting an "economic presence" standard will lead to significant increased tax compliance costs. Moreover, under such statutes, financial institutions would be paying for infrastructure and services that they do not receive, while at the same time they are legally prohibited from establishing a physical presence in which to conduct their business fully. Such treatment flies in the face of the protections afforded by the Commerce and Due Process Clauses of the United States Constitution.

Other unintended effects may follow from an increased tax burden and the uncertainty of complying with "economic presence" income tax statutes. One result could be the restricted availability of credit

across states lines.[7] Furthermore, attempts by the states to enforce tax assessments based on "economic presence" laws will lead to litigation and appeals, ultimately to this Court, involving not only the Commerce Clause and Due Process claims of the banks, but also issues arising out of the National Bank Act of 1864, Ch. 106, 13 Stat. 99 (1864), and the Depository Institutions Deregulation and Monetary Control Act of 1980, United States P.L. 96-221, 94 Stat. 132 (1980).

Thus, the issues generated by the application of an "economic presence" standard range far beyond the narrow, albeit critical issues presented by this case. Therefore, any endorsement of the "economic presence" standard, or any other expansion of state jurisdiction to tax which may be formulated by this Court, should be limited to sales and use tax collection.

CONCLUSION

This Court's 1967 decision in *Bellas Hess* has not been eroded by the evolution of the doctrine of nexus over the past twenty-five years. The reasoning underlying the *Bellas Hess* decision has been affirmed by this Court on several occasions and as recently as 1989. The North Dakota court's departure from the tax nexus standard of physical presence, consistently applied for approximately twenty-five years, should not be permitted since the "economic presence" standard is neither an appropriate nor a practical standard for assessing tax collection liability. Therefore, the Associations urge the Court to reaffirm its holding in *Bellas Hess*.

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[7] Neubig, *The Economic Effects of Destination-Source Taxation of Financial Institutions*, 6 Journal of Bank Taxation 16 (Summer 1991).

However, if the Court should decide this case in favor of the State of North Dakota, the commercial banking and financial service industries respectfully submit that the Court is not required to expand such holding beyond the limited issue of sales and use tax collection presented in this case. Any expansion beyond the sales and use tax collection area and into the area of income or franchise tax jurisdiction is beyond the scope of this case, will create business planning and tax compliance uncertainties and will adversely affect the Commerce Clause standards adopted by this Court.

For all of the reasons stated herein, the American Bankers Association and the American Financial Services Association respectfully urge that the North Dakota Supreme Court's decision in *Quill* be overruled.

Respectfully submitted,

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